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SUBJECT: JANUARY DATA INDICATES A SLOWING IN INFLATION

Sensitive but unclassified. Please handle accordingly.

¶1. (U) In January 2009, the year-on-year change in the urban consumer price index (CPI) declined to 14.4%, its lowest rate in ten months, and down from 18.3% in December 2008 and 23.6% peak in August 2008, according to the official statistics agency CAPMAS. The decline is a result of the drop in the year-on-year change in most of the index items, with the biggest drop in the year-on-year change of food prices. Food price declines are expected to continue, in part due to lower world market prices for commodities imported by the government, including for frozen chicken, oil, rice, etc.

¶2. (U) Egypt's Central Bank (CB) Governor El Okdah had announced earlier this week that a large decline in inflation could lead to more flexibility in monetary policy, but that negative real interest rates continued to slow the decision to cut interest rates to maintain a higher return for the large base of depositors in banks. Consistent with these comments, the Monetary Policy Committee reduced rates on February 12 by 100 pb, the first reduction in almost three years. In its statement, the CBE noted that that a "less restrictive monetary policy is required...to stabilize economic growth around its potential." The statement went on to remind investors that price stability remains the number one objective of the CBE, but that "the CBE would continue to take the necessary measures to contain the adverse effects of the global economic turmoil on the domestic economy." The first business day after the rate announcement, the Egyptian stock exchange was up 2.65 percent (although it still is down 22 percent this year).

¶3. (SBU) Comment: Since the start of the financial crisis, government ministers have become frustrated with the Central Bank's high interest rates. Even President Mubarak seemed to complain about high interest rates in one of his policy speeches last fall. They argued that inflation is coming down, and that interest rates should as well. Bank Governor El Okdah has argued that price stability is the CBE's monetary policy and he has asserted the CBE's independence by not reducing rates until this point. The CBE has moved cautiously and fought the political pressure, as they waited for adequate evidence of a decline in inflation before cutting rates. Given that Central Banks globally have had to loosen monetary policy as a tool to stimulate growth and demand, it is interesting that the Central Bank of Egypt held out so long. Several leading analysts anticipate that rates will fall further this year (perhaps another 200-300 pb) as inflation continues to decline. The most recent IMF Article IV review agreed, on balance, with El Okdah's price stability approach.  
Scobey